



California Economy and Budget

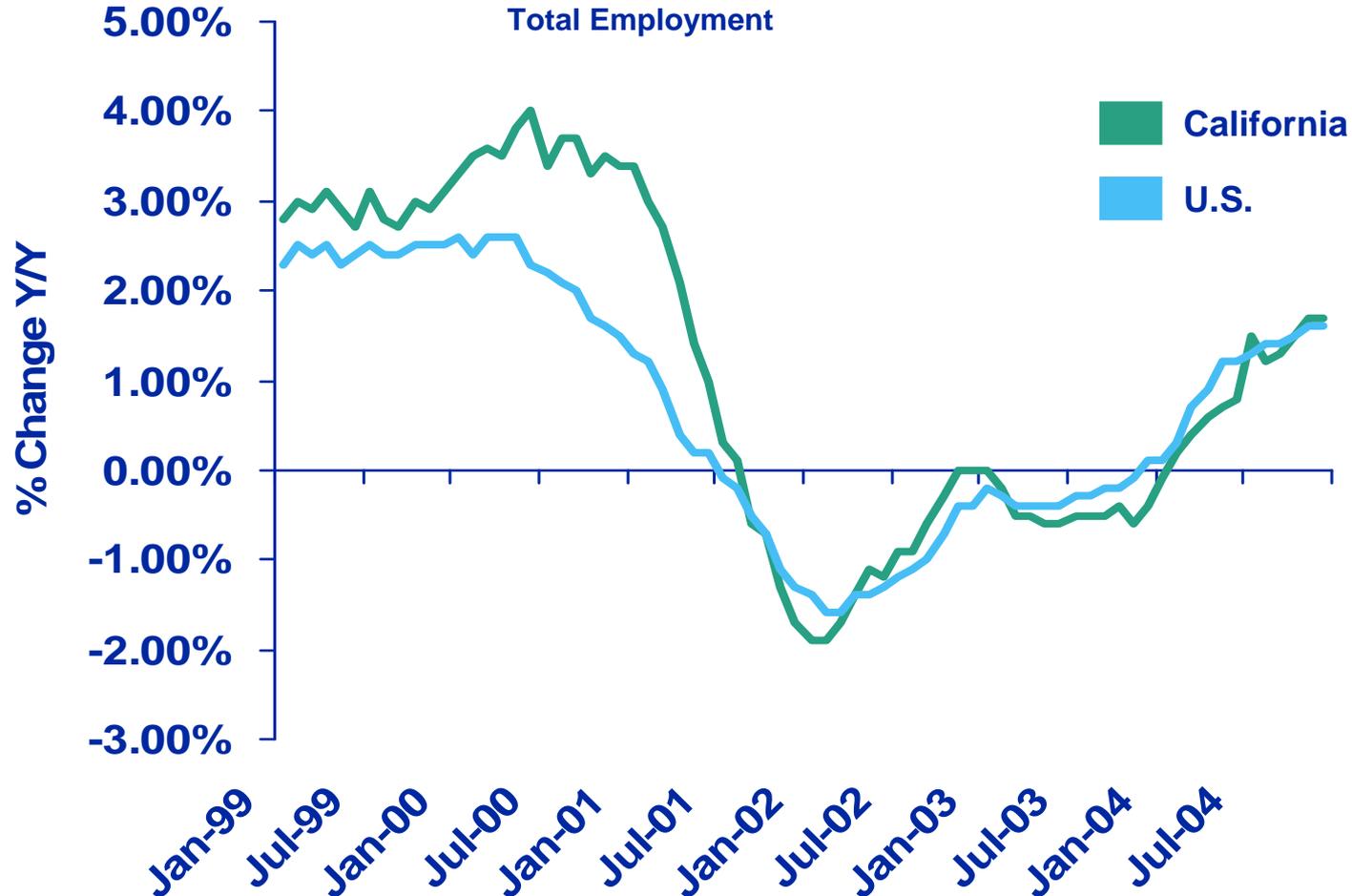
Bond Buyer Conference

Agenda

- 1. The California Economy**
- 2. The California Budget**
- 3. The Economy and the Budget: What Do They Mean for 2011 and Beyond?**
- 4. Conclusion**

California Economy

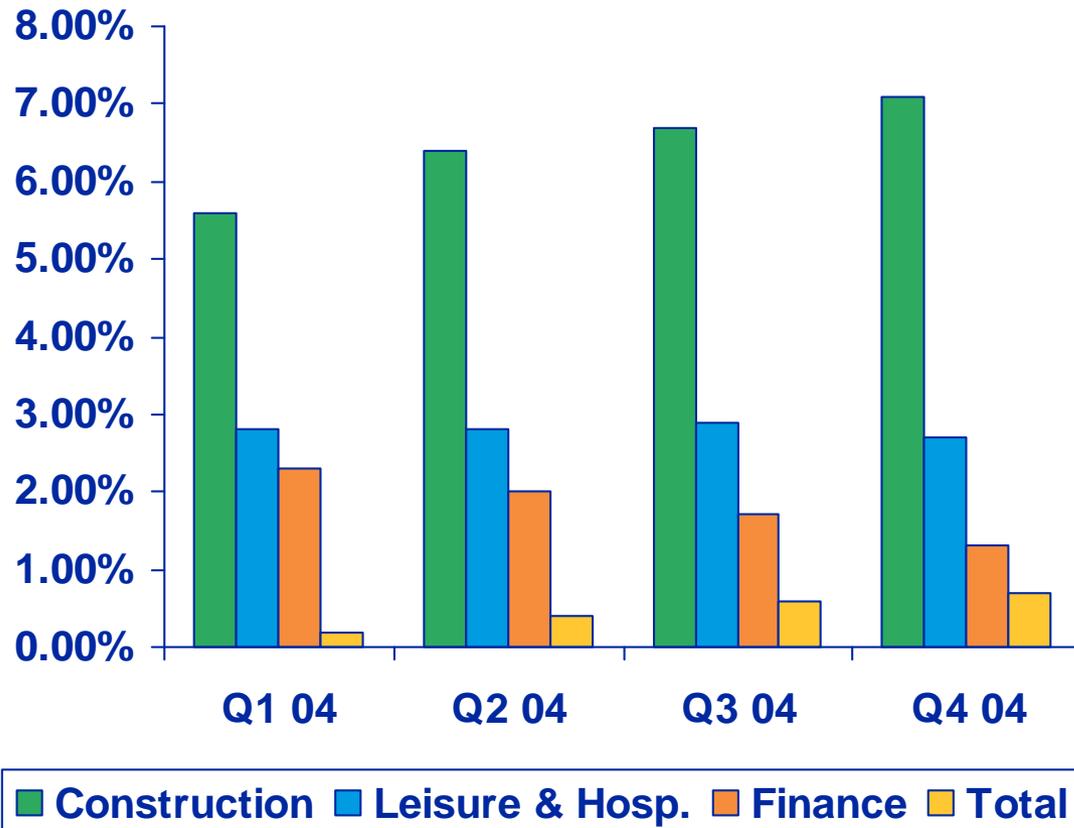
California entered the last recession slightly later than the U.S. and came out at around the same time



California Economy

When California began recovering, it was due in part to a rebound in the housing market

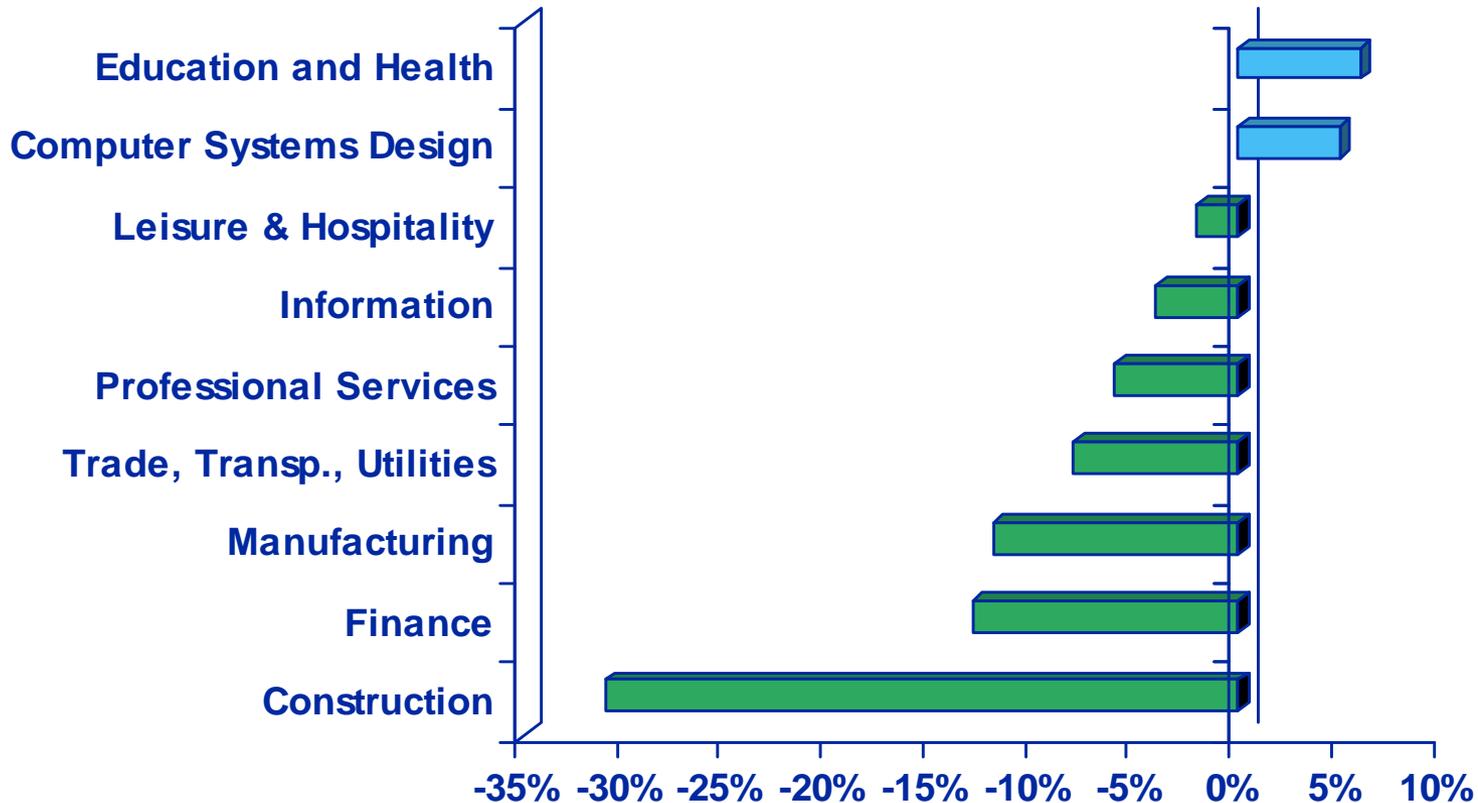
EMPLOYMENT SECTORS LEADING THE LAST RECOVERY IN CALIFORNIA



California Economy

Will the same sectors lead this recovery?

CHANGE IN EMPLOYMENT, JAN 2007-JUL 2009



California Economy

When will the California economy turn around, and what sectors will lead the recovery?

- » California entered this recession before the U.S.
- » Recovery is unlikely to happen before the U.S. recovery
- » The sectors that led the last recovery for the state are still deeply lagging
- » It appears that the California recovery will be led by very different sectors than it was last time
- » Sector most likely to lead the recovery is the high-tech sector
- » The good news is that high-tech research, design, and marketing is a high-income sector

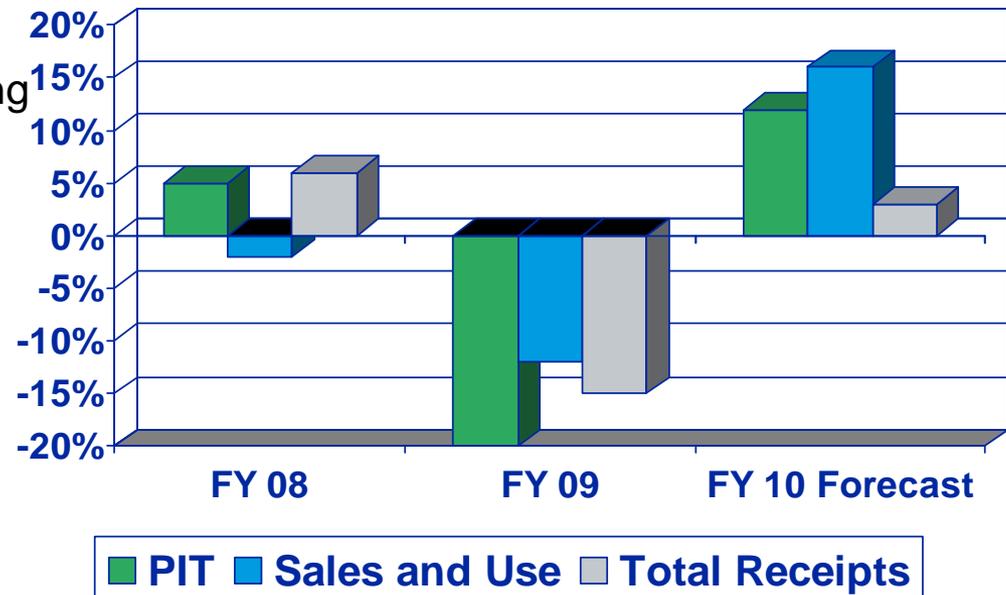
California Budget

The situation in 2009 and 2010

The problems:

- » Declining revenues
- » Restrictions on government's taxing and spending flexibility
- » Large budget gaps
- » Cash crises in January and July 2009

California General Fund Revenues



California Budget

The situation in FY 2009 and 2010

The solutions:

- » Large spending cuts
 - Especially to K-12 education
- » One-time solutions
 - Accounting maneuvers
 - Sale of State Compensation Insurance Fund
 - Taking money from redevelopment agencies
- » Cash payment deferrals
 - Intra-year and inter-year deferrals improve liquidity
- » Borrowing
 - Borrowing from local governments

California Economy and Budget

2011 and beyond?

Structural imbalance will increase due to:

- » Further downward revenue revisions
- » Weak economic recovery
- » One-time solutions
- » Loss of federal stimulus money

Solutions will be difficult to achieve

California Economy and Budget

How are states dealing with the loss of ARRA funding?

Varying approaches to loss of ARRA money in a few years:

- » Some states assume need for spending will decrease as economy improves, so there's no need to plan for loss of ARRA money
- » Some states are attempting to use money strategically in FY10
 - Delaware tried to spend the federal money in the FY10 budget in such a way that the spending won't be needed in the years they don't have it
- » Some states are looking at more active planning
 - Louisiana developed a stimulus policy, including the requirement that agencies that are impacted by federal stimulus funding in FY10 and/or FY11 must develop transition plans or policy changes to address the loss of federal funds in FY11 or FY12

California Economy and Budget

Issuance of Build America Bonds—who is taking advantage?

Partial list of BABs rated by Moody's:

- » States (including CA)
- » Local governments (including at least one CA)
- » Mass transit
- » Universities
- » Turnpike authorities
- » Utilities
- » Water and sewer authorities (including in CA)

California Economy and Budget

Build America Bonds—credit issues we evaluate

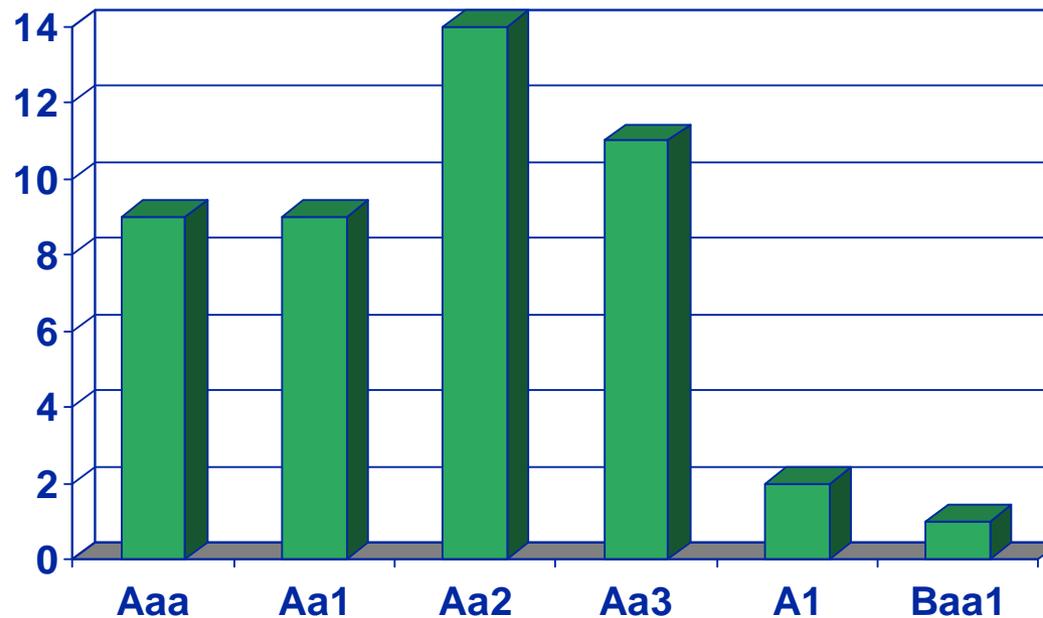
- » Is the interest rate subsidy pledged to the bondholders and, if so, is it anticipated as an off-set against debt service?
- » If the interest rate subsidy is anticipated to make debt service payments, is there a back-up provision in case the subsidy is received after the debt service payment date or the federal government uses its powers of offset or counterclaim?
- » We will assess the issuer's liquidity to determine whether it has the capacity to make the gross debt service payment, if necessary.
- » If there is a reserve fund, what are the replenishment provisions?
- » Who is responsible for submitting the required forms?
- » How is the taxable interest and the interest rate subsidy treated in the rate covenant and ABT?
- » Note: We will consider the subsidy portion of debt service when calculating coverage ratios

California Economy and Budget

Rating implications of the current economic and budget situation on California?

California at Baa1 is the lowest rated state.

State Ratings Distribution





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